

DEPARTMENT OF STATE REVENUE

02950397.LOF

LETTER OF FINDINGS NUMBER: 95-0397 IT
Gross Income Tax - Segregation of Receipts
Gross Income Tax - Grain Dealers
Tax Administration - Negligence Penalty
For Tax Periods: 1990 Through 1992

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Gross Income Tax - Segregation of Receipts

Authority: IC 6-2.1-2-3, IC 6-2.1-2-7

45 IAC 1-1-75, 45 IAC 1-1-115
Storen v. J.D. Adams Manufacturing Co., 212 Ind. 342, 7 N.E.2d 941
(1937)

Taxpayer protests the segregation of receipts from those that qualify for gross earnings treatment.

II. Gross Income Tax - Grain Dealers

Authority: IC 6-2.1-1-5

45 IAC 1-1-75

Taxpayer protests the Department's determination that receipts from the manufacture and sales of animal feed are not eligible for gross earnings treatment.

III. Tax Administration - Negligence Penalty

Authority: IC 6-8.1-10-2.1

45 IAC 15-11-2

Taxpayer protests the imposition of a ten-percent (10%) negligence penalty.

STATEMENT OF FACTS

The taxpayer is a privately owned business with headquarters in New York and regional offices located throughout the United States. Taxpayer's Indiana facilities include a grain operation at one location, the manufacturing and sales of animal and poultry feed at two other locations, and a retail store operation (sold June 30, 1992) at yet another location.

Taxpayer operates mainly as a grain dealer in that it receives, processes, stores and markets whole grain and soybeans. Taxpayer also derives income from many other sources - including the manufacture and sale of animal and poultry feed (animal feed).

The taxpayer uses the gross earnings method to calculate its gross income tax. Taxpayer maintains that as one integrated business, with substantial operations as a grain dealer, it should be allowed to characterize all of its income as "gross earning[s] that are derived from the sale of the whole grain or soybeans." The Department has disagreed. The Department has segregated the taxpayer's earnings derived from its animal feed operation from those earned by the taxpayer as a grain dealer. The Department has determined that the segregated income should be taxed at the low rate as either receipts from selling at retail [45 IAC 1-1-13] or as receipts from wholesale sales [45 IAC 1-1-86]. The segregated income is not eligible for gross earnings treatment.

I. Gross Income Tax - Segregation of Receipts

DISCUSSION

The taxpayer protests the segregation and Are-classification@ of its receipts earned from the manufacture and sales of animal feed from those earned from its grain operations. The taxpayer questions the Department's authority for "making this re-classification" of its income.

Under IC 6-2.1-2-3, the gross income of a taxpayer is subject to different rates of taxation. The different rates of taxation will apply whether it is self-imposed or results from a deficiency discovered in an audit.

45 IAC 1-1-75 informs the taxpayer that:

All gross income except that which is taxable under the gross earnings basis is taxable at the applicable rate or rates upon the total gross receipts basis.

The Department's actions are supported by 45 IAC 1-1-115, which states:

The Act [IC 6-2.1] provides a penalty clause for those taxpayers that fail to segregate different types of income as to the applicable tax rates. If the taxpayer does receive gross income taxable at different rates

and does not separate that income, both in his record keeping and in his reporting to the State, he will be taxed at the highest applicable rate on his gross income.

The Indiana Supreme Court in *Storen v. J.D. Adams Manufacturing Co.*, 212 Ind. 342, 7 N.E.2d 941, 943 (1937) explained:

The rate does not depend upon the business in which the taxpayer is primarily engaged, but the activity from which each item of his gross income is received.

Since there are no provisions in the Indiana code to permit the Department to disregard the source of the income when a deficiency is found in the audit process, the Department's actions were proper.

FINDINGS

The taxpayer's protest is denied. The Department properly segregated taxpayer's income.

II. Gross Income Tax - Grain Dealers

DISCUSSION

The taxpayer protests the Department's determination that receipts from the manufacture and sale of animal feed are not eligible for gross earnings treatment. The taxpayer believes that the receipts earned from the manufacture and sale of animal feed should be afforded gross earnings treatment under IC 6-2.1-1-5.

IC 6-2.1-1-5 states in part:

In the case of grain dealers engaged in the business of receiving, *processing*, storing, and merchandising whole grain and soybeans, "gross income" means the gross earnings that are derived from the sale of the *whole grain or soybeans*. (Italics added.)

45 IAC 1-1-75 emphasizes the nature of allowable activity when it states:

A grain dealer will report his gross income *derived solely from the purchase and sale of whole grain and soybeans* on a gross earnings basis. (Italics added.)

The taxpayer argues that the inclusion of the word "processing" in IC 6-2.1-1-5 broadens the definition of the types of activities that a grain dealer may engage in and still have the receipts qualify for gross earnings treatment. The taxpayer describes its animal feed operation:

In order to produce complete animal feeds, (mostly) corn, (some) soybeans and other by-products are purchased, stored or put through the grain bins and processed into a type of whole grain that will be fed to animals.

Taxpayer believes that the above language describes an activity that falls within the statute's "processing" language. The Department's position is that the taxpayer's earnings from its animal feed division are not eligible for gross earnings treatment.

In the taxpayer's own words:

[Its animal feed division] is a manufacturer of animal and poultry feed using a combination of many ingredients according to formula. All product is thoroughly mixed for uniform distribution of ingredients. Some ingredients are ground prior to incorporation in the mixing stage. Some of the finished product is pelleted, a process of injecting steam and extruding the product through a die to make a harder form of the finished product. The finished product is then shipped either bagged or in bulk form to a network of independent dealers who sell to their farmer customers and to large producers. (From Taxpayer's fax of April 8, 1994.)

As the wording in IC 6-2.1-1-5 indicates, the term "processing" has meaning only to the extent that the end product remains "whole grain or soybeans." The taxpayer has described a manufacturing process in which whole grain, along with other ingredients, is mixed, ground, steamed, and extruded. The finished product is not "*whole grain or soybeans*." Since the taxpayer's earnings are not "*derived from the sale of whole grains or soybeans*," they do not qualify for gross earnings treatment.

In the alternative, the taxpayer asserts that "it should be permitted to deduct certain costs, primarily the cost of purchasing the grain" and believes that "the taxation of its gross receipts would be blatantly unfair and could violate the constitutional uniformity and equality provisions." The taxpayer explains that "[b]y providing some relief for Grain Dealers and Wholesale Grocers (i.e. deduction of costs), the Indiana law has provided for this potential inequity." Taxpayer then argues that those engaged in the manufacture and sales of animal feed should receive similar treatment.

Taxpayer's argument is correct to the extent that its premise states that an animal feed operation is not eligible for gross earnings treatment. While the taxpayer may compare its animal feed operation to that of Grain Dealers [6-2.1-1-5] or Wholesale Grocers [6-2.1-1-4], under Indiana statute, the taxpayer's animal feed operation does not qualify for similar treatment.

Regarding the taxpayer's concern about the "constitutional uniformity" of Indiana tax policy, the Department presumes the constitutionality of tax assessments under the provisions of Indiana Code 6-2.1.

FINDING

The taxpayer's protest is respectfully denied. The statute designates "whole" in reference to grain and soybeans. Unless the grain or soybean is sold in a "whole" state, the statute permitting gross earnings treatment does not apply. The manufacture of animal feed from whole grain does not fall under the ambit of either statute or regulation because the operation is not a grain dealer operation.

III. Tax Administration - Negligence Penalty

DISCUSSION

The taxpayer protests the Department's imposition of the ten-percent (10%) penalty. A negligence penalty may be imposed under IC 6-8.1-10-2.1 and 45 IAC 15-11-2.

45 IAC 15-11-2 provides:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-2.1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

The taxpayer explained in its protest letter that the "Grain Dealer classification for all its activities in Indiana... has been accepted during prior audits *even though questions were raised and the issue discussed*. (Italics added.)

On December 4, 1990, the taxpayer received a letter from the Department, which stated:

Effective with any tax return filed after March 15, 1990, for the purpose of computing gross income tax, 45 IAC 1-1-75 [Gross earnings of grain dealers] and 45 IAC 1-1-76 [Price controls on grain and soybeans] will be strictly applied. (Bracketed items added for clarification.)

In this instance, the taxpayer has not shown reasonable cause. The taxpayer has not provided sufficient justification for not complying with the Indiana gross income tax statutes.

FINDING

The taxpayer's protest is denied. The negligence penalty is appropriate.